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"PROSECUTION, REGULATION AND PROMOTION
IN SECURITIES REGULATION"

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THE SECURITIES AND EXCHANGE COMMISSION IS CUSTOMARILY VIEWED AS A PROSECUTORIAL AGENCY, A TOUGH ENFORCER WHICH POLICES WALL STREET AND BIG BUSINESS TO KEEP THE CAPITALISTS HONEST. THIS IMAGE OF THE COMMISSION IS NOT ENTIRELY COMPLETE OR ACCURATE, HOWEVER. THE COMMISSION HAS ALWAYS HAD SUBSTANTIAL REGULATORY FUNCTIONS. AND THE 1975 AMENDMENTS TO THE SECURITIES LAWS GAVE THE COMMISSION SIGNIFICANT NEW PROMOTIONAL FUNCTIONS. I AM GOING TO TALK TO YOU THIS AFTERNOON ABOUT THE COMMISSION'S PROMOTIONAL ACTIVITIES AND RESPONSIBILITIES BECAUSE I BELIEVE THAT THERE HAS BEEN INSUFFICIENT ATTENTION GIVEN TO THE ROLE OF THE SEC AS A PROMOTER.

A RECENTLY PUBLISHED STUDY ON FEDERAL REGULATION BY THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS EXPLAINS THAT

FROM THE BEGINNING OF THE NATION, THE FEDERAL GOVERNMENT HAS BEEN CONCERNED WITH BOTH AIDING BUSINESS DEVELOPMENT AND WITH PROTECTING THE PUBLIC FROM ABUSES RESULTING FROM BUSINESS PRACTICES. THE HISTORY OF GOVERNMENT INVOLVEMENT WITH BUSINESS IN THIS COUNTRY MIGHT BE DESCRIBED AS AN EFFORT TO BALANCE A GROWING NATION'S NATURAL DESIRE TO FOSTER ITS ECONOMY BY AIDING BUSINESS DEVELOPMENT AND, AT THE SAME TIME, TO GUARD AGAINST HEALTH AND SAFETY RISKS, MONOPOLISTIC PRACTICES AND OTHER UNFAIR BUSINESS PRACTICES RESULTING FROM UNREGULATED BUSINESS ACTIVITY. . . . GOVERNMENT ACTIVITY RELATING TO BUSINESS MAY BE VIEWED ON A CONTINUUM FROM PURE PROMOTION OR BENEFIT-GRANTING ACTIVITY AT ONE END, TO STRAIGHT LAW ENFORCEMENT ON THE OTHER.

THE SENATE COMMITTEE CLASSIFIED THE SEC ON THIS CONTINUUM AS A PURELY LAW ENFORCEMENT AGENCY, WHICH POLICES THE ECONOMY TO INSURE THAT COMPANIES AND INDIVIDUALS ADHERE TO THE STATUTES AND AGENCY REGULATIONS HAVING THE FORCE OF LAW. THIS VIEW OF THE SEC WAS PUNGENTLY EXPRESSED BY WILLIAM O. DOUGLAS, AN EARLY CHAIRMAN OF THE COMMISSION AND THEN SUPREME COURT JUSTICE, AT THE TWENTY-FIFTH ANNIVERSARY PARTY FOR THE SEC IN 1959. HE SAID THEN: "THE MAIN DIFFERENCE I SEE BETWEEN THE OLD SEC AND THE NEW ONE IS THAT WE PUT IN PRISON A MUCH HIGHER TYPE OF PERSON."

IN 1975, CONGRESS DETERMINED THAT THE SECURITIES MARKETS ARE A VITAL NATIONAL ASSET WHICH CAN BEST BE PRESERVED AND STRENGTHENED THROUGH THE DEVELOPMENT OF A NATIONAL MARKET SYSTEM. THIS SYSTEM SHOULD UTILIZE NEW DATA PROCESSING AND COMMUNICATIONS TECHNIQUES IN ORDER TO LINK ALL MARKETS FOR "QUALIFIED SECURITIES." THE OBJECTIVES OF THE NATIONAL MARKET SYSTEM, AS SET FORTH IN SECTION 11A(A)(1) OF THE SECURITIES EXCHANGE ACT OF 1934, ARE TO CREATE ECONOMICALLY EFFICIENT MECHANISMS FOR THE BEST EXECUTION OF SECURITIES TRANSACTIONS, TO INCREASE THE AVAILABILITY TO BROKER-DEALERS AND INVESTORS OF MARKET QUOTATION AND TRANSACTION INFORMATION, AND GENERALLY TO ENHANCE COMPETITION IN MARKET-MAKING.

CONGRESS DIRECTED THE SEC TO FACILITATE THE ESTABLISHMENT OF A NATIONAL MARKET SYSTEM (AND ANY NECESSARY SUBSYSTEMS) IN ACCORDANCE WITH THESE LAUDABLE BUT RATHER VAGUE, OBJECTIVES. IN ADDITION, THE 1975 AMENDMENTS ALSO DIRECTED THE SEC TO FACILITATE THE ESTABLISHMENT OF A NATIONAL SYSTEM FOR PROMPT AND ACCURATE CLEARANCE AND SETTLEMENT OF TRANSACTIONS.

THIS MANDATE GIVES THE SEC BOTH REGULATORY AND PROMOTIONAL FUNCTIONS. THE SEC HAS BEEN APPROACHING THOSE PROMOTIONAL RESPONSIBILITIES WITH CAUTION, AND PERHAPS EVEN SOME UNEASE. I BELIEVE THAT ONE REASON THE SEC HAS BEEN RELUCTANT TO ASSUME A STRONG PROMOTIONAL ROLE IN THE DEVELOPMENT OF NATIONAL MARKET AND CLEARANCE SYSTEMS IS THAT PROMOTIONAL PROGRAMS ARE NOT A TRADITIONAL ASPECT OF THE AGENCY'S WORK.

THE SENATE COMMITTEE STUDY TO WHICH I REFERRED PREVIOUSLY CONCLUDED THAT PROMOTIONAL AND REGULATORY PROGRAMS CANNOT COMFORTABLY CO-EXIST IN A SINGLE AGENCY. THE EXPLANATION FOR THIS INCOMPATIBILITY WAS ARTICULATED AS FOLLOWS:

IN RECENT YEARS, CONGRESS HAS INCREASINGLY MADE EFFORTS TO SEPARATE PROMOTIONAL... ACTIVITY ORGANIZATIONALLY FROM THE FUNCTION OF REGULATION. EXPERIENCE HAS DEMONSTRATED THAT WHEN BOTH FUNCTIONS ARE ASSIGNED TO A SINGLE AGENCY, THERE IS A GENERAL TENDENCY FOR THE AGENCY'S PROMOTIONAL MISSION TO PREDOMINATE.

I BELIEVE THERE IS SOME MERIT TO THIS OBSERVATION, AND IT IS THEREFORE IRONIC THAT CONGRESS RECENTLY GAVE THE SEC IMPORTANT NEW PROMOTIONAL PROGRAMS. IN ADDITION TO HAVING ALMOST NO PROMOTIONAL EXPERIENCE, THE SEC'S REGULATORY FUNCTIONS HAVE, IN THE PAST, DOMINATED ANY PROMOTIONAL FUNCTIONS IT HAD. FURTHER, THE SEC HAS TRADITIONALLY RELIED TO SOME EXTENT UPON ITS PROSECUTORIAL POWERS TO ACHIEVE ITS REGULATORY OBJECTIVES.

THE ABILITY OF AN EFFECTIVE PROSECUTOR TO BE AN EQUALLY EFFECTIVE PROMOTER IS WORTH QUESTIONING. A SOMEWHAT CAUSTIC CRITIC OF THE SEC RECENTLY WROTE:

THE S.E.C. HAS ALWAYS BEEN A REGULATOR-- AN INVESTIGATOR OF FRAUD, A COMPELLER OF CORPORATE DISCLOSURE, A DETERMINER OF STANDARDS--NOT A CREATOR OF STRUCTURES OR AN INVENTOR OF SYSTEMS. SO THE COMMISSION'S METHOD OF EFFECTING CHANGE /IN MARKET SYSTEMS/ HAS REVOLVED AROUND REPEAL, WORKING THROUGH NEGATIVE--IN EFFECT, DESTRUCTIVE--RULINGS. MILLER, "IS THE S.E.C. SELLING WALL STREET SHORT?" THE N.Y. TIMES MAGAZINE, 18, 20 (APRIL 23, 1978).

ALSO WORTH QUESTIONING IS WHETHER THE SEC WILL IMPAIR THE EFFECTIVENESS OF ITS PROSECUTORIAL PROGRAMS BY ESTABLISHING GOOD PROMOTIONAL PROGRAMS. IF THE SEC IS ENGAGED IN PROMOTING THE DEVELOPMENT OF NATIONAL MARKET AND CLEARANCE SYSTEMS, AND THE VIABILITY OF PARTICIPANTS IN THOSE SYSTEMS, WILL IT CONTINUE TO BE ABLE TO PROSECUTE THOSE PARTICIPANTS VIGOROUSLY FOR VIOLATIONS OF THE SECURITIES LAWS?

IT SEEMS TO ME THAT IN THE PAST FEW YEARS THE SEC HAS INSTITUTED PROPORTIONATELY FEWER ENFORCEMENT CASES AGAINST BROKER-DEALERS, AND OTHER REGISTERED ENTITIES IN THE SECURITIES INDUSTRY SUCH AS INVESTMENT COMPANIES AND ADVISORS, AND PROPORTIONATELY MORE CASES AGAINST ISSUERS OF SECURITIES. YOU MAY WELCOME THIS ATTENTION TO OTHERS AND BE HAPPY TO HAVE THE ENFORCEMENT STAFF LOOKING AT THE MANAGEMENT FRAUDS OF INDUSTRIAL CORPORATIONS IN ADDITION TO YOUR OWN BOOKS AND RECORDS AND POSSIBLY FRAUDULENT TRANSACTIONS. NO DOUBT YOU BELIEVE YOU ARE BEING OVER INVESTIGATED, AND I AM NOT SUGGESTING THAT OUR ENFORCEMENT STAFF HAS GONE SOFT ON WALL STREET. HOWEVER, I AM FRANKLY WORRIED THAT THE SEC IS NOT GIVING SUFFICIENT PRIORITY IN ITS ENFORCEMENT ACTIVITIES TO THE SECURITIES INDUSTRY'S COMPLIANCE WITH THE SECURITIES LAWS AND REGULATIONS. I WORRY THAT WE MAY NOT BE CONCENTRATING ON INSPECTION PROGRAMS FOR MEMBERS OF THE INDUSTRY, INCLUDING NEW REGISTRANTS UNDER THE 1975 AMENDMENTS, BECAUSE WE ARE CONCENTRATING ON HOW TO FULFILL OUR PROMOTIONAL MANDATES UNDER THE 1975 AMENDMENTS.

I CERTAINLY HOPE THAT THE SEC WILL BE ABLE TO MAINTAIN ITS REPUTATION AND EFFECTIVENESS AS A PROSECUTOR AND REGULATOR AND AT THE SAME TIME BE CREATIVE, CONSTRUCTIVE AND EQUALLY EFFECTIVE AS A PROMOTER. I HOPE THAT THESE ROLES ARE COMPATIBLE, AND I INTEND TO WORK TOWARD THEIR RECONCILIATION. NEVERTHELESS, I BELIEVE THERE ARE POINTS OF CONFLICT BETWEEN OUR PROSECUTORIAL AND PROMOTIONAL ROLES WHICH CAN CAUSE CONFUSION IF BOTH THE AGENCY AND THE INDUSTRY ARE NOT SENSITIVE TO QUESTIONS OF DIRECTION AND PRIORITY.

A VARIETY OF ECONOMIC AND POLITICAL FORCES HAVE COALESCED TO FORCE THE SEC INTO ASSUMING A NEW AND UNCOMFORTABLE PROMOTIONAL ROLE WITH RESPECT TO THE SECURITIES INDUSTRY. I WILL MENTION A FEW OF THE FORCES; YOU MAY DISCERN OTHERS. ENORMOUS AND APPARENTLY CONTINUING INCREASES IN THE VOLUME OF SECURITIES TRANSACTIONS HAVE CREATED THE NEED FOR TECHNOLOGICAL MODERNIZATION OF THE SECURITIES INDUSTRY. HOWEVER, CAPITAL TO INVEST IN THE INDUSTRY IS SCARCE BECAUSE THE RETURN ON CAPITAL, CONSIDERING INFLATION AND THE RISKS OF THE BUSINESS, DOES NOT MAKE SUCH AN INVESTMENT ATTRACTIVE. BUT THE DEVELOPMENT OF NATIONAL MARKET AND CLEARANCE SYSTEMS IS GOING TO COST MONEY. THESE SYSTEMS WILL ALSO AFFECT THE RELATIVE COMPETITIVE POSITIONS OF VARIOUS PARTICIPANTS IN THE SECURITIES INDUSTRY SO THERE IS NOT AN EQUAL INCENTIVE FOR ALL MEMBERS OF THE INDUSTRY TO BEAR THE COSTS OF DEVELOPMENT.

THE U.S. SECURITIES INDUSTRY IS THREATENED BY FOREIGN COMPETITION, ESPECIALLY FROM ENTITIES WHICH ARE ABLE TO COMBINE BANKING AND BROKERAGE FUNCTIONS, AND ARE RELATIVELY FREE FROM GOVERNMENT REGULATION. AT THE SAME TIME, THE INDUSTRY IS SEEKING FOREIGN CAPITAL, AND TO SOME EXTENT HAS BEEN SUCCESSFUL IN ATTRACTING SUCH INVESTMENT. THE BROKERAGE INDUSTRY HAS ALSO BEEN HEARD TO COMPLAIN OF UNFAIR COMPETITION FROM BANKS. (I SHOULD SAY THAT I HAVE NEVER HEARD ANYONE COMPLAIN ABOUT COMPETITION WHICH WAS NOT UNFAIR. I SUPPOSE FAIR COMPETITION IS WHEN YOU BEAT YOUR COMPETITORS.)

BUT THE SECURITIES INDUSTRY IS ALSO ATTEMPTING TO COMPETE IN NEW WAYS WITH THE BANKING INDUSTRY, BOTH IN THE U.S. AND ABROAD.

THE NEED OF THE INDUSTRY TO DEVELOP NEW TRADING AND CLEARANCE FACILITIES TO A LARGE EXTENT COMES FROM THE PRESSURES WHICH INSTITUTIONALIZATION OF THE SECURITIES MARKETS HAS PLACED ON EXISTING FACILITIES. ACCORDING TO THE LEGISLATIVE HISTORY OF THE 1975 AMENDMENTS, NATIONAL MARKET AND CLEARANCE SYSTEMS ARE BEING DEVELOPED TO SERVE ALL INVESTORS. INSTITUTIONS USE THOSE SYSTEMS IN LARGE NUMBERS, DEMAND EFFICIENCY AND LIQUIDITY, AND DOMINATE THE MARKETPLACE. BUT INSTITUTIONAL INVESTORS ARE NOT PAYING FOR THE DEVELOPMENT OF NEW SYSTEMS. THEY ARE SEEKING THE LOWEST POSSIBLE COSTS IN MARKET EXECUTIONS AND FOR THE MOST PART THEY HAVE NOT BEEN INVOLVED IN THE DEVELOPMENT OF NEW SYSTEMS.

A RECENT CONFERENCE OF INSTITUTIONAL INVESTORS FEATURED AN AUDIENCE POLL ON THE QUESTION OF WHETHER THERE ARE TANGIBLE BENEFITS IN MOVING TOWARD A NATIONAL MARKET SYSTEM, OR WHETHER THE GOVERNMENT IS FORCING CHANGES IN WHICH NEITHER THE INDUSTRY NOR ITS CUSTOMERS SEE ANY BENEFIT. THE AUDIENCE WAS EVENLY DIVIDED ON THE QUESTION. (SECURITIES WEEK, P. 13 (APRIL 24, 1978).)

ALTHOUGH THE NEED FOR CAPITAL ON WALL STREET IS SERIOUS, THE PROMOTIONAL ROLE OF THE SEC WITH RESPECT TO MARKET STRUCTURE DOES NOT INCLUDE THE GRANTING OF SUBSIDIES OR CONTRACTS FOR THE DEVELOPMENT OF A NATIONAL MARKET OR CLEARANCE SYSTEM. FURTHER, A GOVERNMENT AGENCY IS NOT A PROFIT MAKING INSTITUTION, AND SO THE SEC HAS A LIMITED CAPACITY TO FORMULATE IDEAS FOR SYSTEMS ON THE BASIS OF THEIR ECONOMIC FEASIBILITY. EVEN THOUGH THE COMMISSION HAS BEEN GIVEN SOME PROMOTIONAL DUTIES, IT REMAINS A BASICALLY REGULATORY AGENCY WITH NEITHER THE MANDATE NOR THE RESOURCES TO SOLVE FUNDAMENTAL ECONOMIC PROBLEMS.

TWO STORIES FROM THE AUTOBIOGRAPHY OF WILLIAM O. DOUGLAS (GO EAST YOUNG MAN, PP. 284, 292 RANDOM HOUSE 1974) PERHAPS BEST ILLUSTRATE THESE POINTS. WHEN DOUGLAS WAS CHAIRMAN OF THE COMMISSION, SIDNEY J. WEINBERG OF GOLDMAN, SACHS AND COMPANY CAME INTO HIS OFFICE WITH A WORRIED LOOK ON HIS FACE "WHAT'S THE PROBLEM?" DOUGLAS ASKED. WEINBERG REPLIED, "CAN'T YOU LET US HAVE A DAILY VOLUME OF TRADING ON THE BIG BOARD OF SIX HUNDRED THOUSAND SHARES?" DOUGLAS ASKED WEINBERG WHAT THE SEC HAD TO DO WITH TRADING VOLUME. WEINBERG RESPONDED THAT UNTIL THE NEW DEAL EVERYTHING HAD BEEN FINE, THE VOLUME WAS UP, AND BROKERS COULD LIVE ON THEIR FEES. BUT AFTER THE NEW DEAL IT WAS DIFFERENT; WALL STREET HAD TO SELL AT LEAST SIX HUNDRED THOUSAND SHARES A DAY FOR BROKERS TO BREAK EVEN.

THE COSTS OF GOVERNMENT REGULATION TO THE SECURITIES INDUSTRY HAVE OBVIOUSLY RISEN, AND SO HAS THE BREAK EVEN VOLUME. HOWEVER, THE SEC HAS NEVER BEEN RESPONSIBLE FOR GENERAL ECONOMIC POLICY WHICH AFFECTS THE SECURITIES INDUSTRY MORE SEVERELY THAN SEC REGULATION. WHEN DOUGLAS HAD BEEN SEC CHAIRMAN FOR ONLY A FEW DAYS THE NEW YORK STOCK EXCHANGE WENT INTO THE DECLINE KNOWN AS BLACK TUESDAY. THE PRESIDENT OF THE EXCHANGE CALLED DOUGLAS AND ASKED HIM TO CLOSE THE EXCHANGE. PRESIDENT ROOSEVELT SUGGESTED THAT THE MARKET DECLINE WAS A CONSPIRACY BETWEEN BUSINESS AND WALL STREET AGAINST DOUGLAS. "MR. PRESIDENT," DOUGLAS REPLIED, "YOU ARE DEAD WRONG. THE MARKET IS GOING DOWN BECAUSE YOU CUT SPENDING."

I AM NOT SURE THAT THE ENSUING THIRTY YEARS HAVE TAUGHT ANY OF US VERY MUCH. THERE IS NO DOUBT IN MY MIND THAT A ROARING BULL MARKET WOULD EASE THE DEVELOPMENT OF NATIONAL MARKET AND CLEARANCE SYSTEMS AND MUTE THE INDUSTRY'S CRITICISM OF THE COMMISSION. IN THE MEANTIME, THE SEC WILL HAVE TO STRUGGLE TO COMPLY WITH CONGRESS' DIRECTIVE TO FACILITATE THE DEVELOPMENT OF SYSTEMS WHICH MANY MARKET PARTICIPANTS AND THEIR CUSTOMERS DO NOT UNDERSTAND OR MAY NOT EVEN WANT. I BELIEVE THAT THE ONLY WAY IN WHICH THE COMMISSION CAN RESPONSIBLY FULFILL THIS PROMOTIONAL ROLE AND MAINTAIN A PROPER BALANCE BETWEEN ITS PROSECUTORIAL, PROMOTIONAL AND REGULATORY FUNCTIONS IS TO RELY HEAVILY UPON THE SELF REGULATORY ORGANIZATIONS.

SELF REGULATION HAS BEEN AN INTEGRAL PART OF THE STATUTORY SCHEME FOR THE FEDERAL REGULATION OF THE SECURITIES MARKETS SINCE 1934. ALTHOUGH CONGRESS WAS WELL AWARE THAT SELF REGULATION MAY BE USED AS A DEVICE TO AVOID REGULATION, THAT RISK WAS BALANCED AGAINST THE SHEER INEFFECTIVENESS OF ATTEMPTING TO PROVIDE REGULATION DIRECTLY THROUGH THE GOVERNMENT ON A WIDE SCALE. THEREFORE, WHEN CONGRESS CREATED THE SEC IT PRESERVED THE SECURITIES EXCHANGES AS SELF REGULATORY ORGANIZATIONS, EXPRESSING THE HOPE THAT THE EXCHANGES WOULD EFFECT NEEDED REFORMS SO THAT DIRECT ACTION BY THE SEC WOULD NOT BE NECESSARY.

THEN IN 1938 CONGRESS EXTENDED THE CONCEPT OF SELF REGULATION TO THE REGULATION OF OVER-THE-COUNTER BROKERS AND DEALERS, BY ENACTING THE MALONEY ACT WHICH LED TO THE FORMATION OF THE NASD. THE LEGISLATIVE HISTORY OF THE MALONEY ACT INDICATES THE BELIEF THAT, EVEN IF THE FUNDS AND STAFF FOR REGULATION OF THE MARKETS WERE PROVIDED BY CONGRESS, MANY OF THE ABUSES IN THE SECURITIES INDUSTRY WERE MORE A MATTER OF ETHICS THAN ILLEGALITY. THEREFORE, SELF-REGULATION WAS CONSIDERED PREFERABLE TO THE BUREAUCRATIC EVILS WHICH WOULD RESULT FROM A DETAILED AND RIGID REGULATION OF BUSINESS BY THE GOVERNMENT.

IN 1963, THE COMMISSION'S SPECIAL STUDY OF SECURITIES MARKETS UNDERTOOK A COMPREHENSIVE EXAMINATION OF THE EFFECTIVENESS OF SELF REGULATION.

THE SPECIAL STUDY FOUND MUCH TO PRAISE ABOUT THE SELF-REGULATORY PROCESS AND CONCLUDED THAT REGULATION OF THE SECURITIES MARKETS SHOULD CONTINUE TO BE BASED ON THE PRINCIPLE OF GIVING MAXIMUM SCOPE TO SELF-REGULATION. HOWEVER, THE SPECIAL STUDY ALSO WARNED OF THE DANGERS OF THE ANTI-COMPETITIVE TENDENCIES OF SELF REGULATION, AND STRESSED THE NEED FOR EFFECTIVE GOVERNMENTAL CONTROL:

SELF REGULATION BY A MEMBER ORGANIZATION INVOLVES SOME DEGREE OF IMPAIRMENT OF COMPETITION AND PUBLIC CONTROL IS NECESSARY NOT ONLY TO INSURE THAT SUCH IMPAIRMENT IS COMPENSATED FOR BY EFFECTIVE REGULATION, BUT ALSO TO INSURE THAT THE KINDS AND EXTENT OF IMPAIRMENT ARE ONLY SUCH AND NO GREATER THAN REQUIRED BY THE EXIGENCIES OF REGULATION. INHERENT IN SELF-REGULATION IS THE "PRIVATE" FORMULATION OF RESTRICTIVE STANDARDS OF BUSINESS CONDUCT AND THEIR ENFORCEMENT BY, AT THE VERY LEAST, EXCLUSIONARY PRACTICES.

THE NOTION THAT ONE OF THE UNDESIRABLE ASPECTS OF SELF-REGULATION WAS ITS ANTI-COMPETITIVE TENDENCY WAS REITERATED DURING THE CONGRESSIONAL HEARINGS AND STUDIES OF THE 1970s WHICH EVENTUALLY LED TO THE SECURITIES ACT AMENDMENTS OF 1975. THIS CRITICISM WAS EXPRESSED VERY WELL IN THE 1973 STUDY BY THE SENATE SUBCOMMITTEE ON SECURITIES AS FOLLOWS:

REGULATION BY GOVERNMENT AND BY INDUSTRY GROUPS, IS AN ESSENTIAL ELEMENT IN PROTECTION OF INVESTORS, BUT IS NOT AN EFFECTIVE SUBSTITUTE FOR COMPETITION IN ASSURING A FLEXIBLE AND HEALTHY INDUSTRY. THE CONCEPT OF INDUSTRY SELF-REGULATION, SUBJECT TO SEC OVERSIGHT, IS WELL ADAPTED TO DEALING WITH PROBLEMS OF CONDUCT AND ETHICS, BUT IS NOT WELL ADAPTED TO DEALING WITH GENERAL ECONOMIC QUESTIONS INVOLVING COMPETITIVE INTERRELATIONSHIPS AMONG FIRMS WITHIN THE INDUSTRY.

THE 1975 AMENDMENTS WERE DESIGNED IN PART TO REMEDY SELF-REGULATORY DEFICIENCIES. THE MAJOR CHANGES THAT THE 1975 AMENDMENTS MADE IN THE SELF-REGULATORY PROCESS CONCERN SELF-REGULATORY RULEMAKING, MEMBERSHIP, RULE ENFORCEMENT, AND DISCIPLINARY ACTIONS. THE LEGISLATIVE HISTORY OF THE STATUTE INDICATES THAT CONGRESS INTENDED TO STRENGTHEN THE TOTAL REGULATORY FABRIC, RATHER THAN TO DIMINISH THE ROLE OF SELF-REGULATION.

CONGRESS HAS CONSISTENTLY RECOGNIZED THAT SELF-REGULATION IN THE SECURITIES INDUSTRY HAS MADE IT POSSIBLE FOR THE SEC TO REMAIN A SMALL, FLEXIBLE AND PROFESSIONAL AGENCY. BOTH THE INDUSTRY AND THE COMMISSION WERE ABLE TO AVOID THE STULTIFYING EFFECT OF DETAILED BUREAUCRATIC REGULATION OF DAY TO DAY BUSINESS ACTIVITIES. CONGRESS HAS ALSO RECOGNIZED THE ANTI-COMPETITIVE INSTINCTS OF THE SELF-REGULATORY ORGANIZATIONS AND HAS ATTEMPTED TO COMPENSATE FOR THIS WEAKNESS IN THE REGULATORY STRUCTURE BY MANDATING MORE REGULAR AND MORE AGGRESSIVE OVERSIGHT BY THE SEC. I HOPE THIS NEW OVERSIGHT WILL NOT CHANGE OUR AGENCY FOR THE WORSE.

I THINK THAT ANOTHER VERY POSITIVE ASPECT OF THE SELF REGULATORY SCHEME HAS NOT RECEIVED MUCH ATTENTION. BECAUSE THE SELF-REGULATORY AGENCIES HAVE PLAYED A SIGNIFICANT PROMOTIONAL ROLE, NEITHER THE SEC NOR ANY OTHER GOVERNMENT AGENCY HAS HAD TO PLAY A PROMOTIONAL ROLE FOR THE INDUSTRY. I KNOW THAT SOME OF YOU DO NOT AGREE THAT IT IS GOOD FOR AN INDUSTRY TO LACK A PROMOTER IN THE GOVERNMENT. BUT I BELIEVE THAT THE INDUSTRY IS BETTER OFF ON ITS OWN, WITHOUT SUBSIDIES AND WITHOUT PROTECTIONIST GOVERNMENT-MANDATED SUPPORTS. GOVERNMENT SUPPORT BRINGS GOVERNMENT CONTROL AND THIS CYCLE IS ULTIMATELY DEBILITATING.

TO THE EXTENT THAT THE SEC HAS BEEN GIVEN PROMOTIONAL RESPONSIBILITIES IN THE 1975 AMENDMENTS, IT HAS MADE EVERY EFFORT TO SHARE THOSE RESPONSIBILITIES WITH THE INDUSTRY, AND ESPECIALLY THE SELF-REGULATORY ORGANIZATIONS. IT IS CRUCIAL TO THE FUTURE OF SELF-REGULATION THAT THE INDUSTRY RESPOND CONSTRUCTIVELY AND RESPONSIBLY TO THE CHALLENGES OF DEVELOPING NATIONAL MARKET AND CLEARING SYSTEMS.

THE INDUSTRY HAS NOT ALWAYS DEMONSTRATED A CAPACITY FOR CREATIVE RESPONSE TO CHANGE. IN THE 1960S THE PROMOTIONAL ROLE OF THE SELF-REGULATORY ORGANIZATIONS WAS MUCH TOO MYOPIC. THE RESULT WAS THE TRANSFER OF SOME PROMOTIONAL FUNCTIONS TO THE GOVERNMENT. IN ADDITION TO THE LOSS OF INITIATIVE, THE INDUSTRY SUFFERED A LOSS OF FREEDOM. I HOPE THAT LESSON IS NOT LOST ON THIS GROUP OF INDUSTRY LEADERS.

OUR SOCIAL FABRIC IS HELD TOGETHER BY VARIOUS INSTITUTIONS OF AUTHORITY. TODAY'S LAWLESSNESS AND ANTI-SOCIAL BEHAVIOR, IN THE FORM OF WHITE COLLAR AS WELL AS STREET CRIME, IS SOME EVIDENCE OF DISINTEGRATION OF THAT SOCIAL FABRIC. IN THE SECURITIES INDUSTRY, THE EXCHANGES AND THE NASD HAVE TRADITIONALLY SERVED AS INSTITUTIONS OF AUTHORITY EXERCISING A POSITIVE INFLUENCE ON THE MORALS OF THE MARKETPLACE. I BELIEVE THAT THE SELF-REGULATORY ORGANIZATIONS HAVE HAD THE LEVERAGE TO ESTABLISH AND ENFORCE A REGULATORY SYSTEM BECAUSE OF THEIR PROMOTIONAL ACTIVITIES.

THE LEGITIMACY OF OUR INSTITUTIONS OF AUTHORITY SEEMS TO BE IN QUESTION TODAY, AND THE EXCHANGES AND NASD HAVE CERTAINLY NOT ESCAPED THIS INQUIRY. THE SELF-REGULATORY ORGANIZATIONS DID NOT PERFORM WELL IN DEALING WITH THE PAPER WORK CRISIS OF THE 1960s, THE FIXED MINIMUM COMMISSION SCHEDULE AND OTHER DEVELOPMENTS RELATED TO THE INSTITUTIONALIZATION OF THE MARKETS. ONE REASON THE SELF-REGULATORY ORGANIZATIONS FAILED TO RESPOND EFFECTIVELY TO THESE DEVELOPMENTS WAS THAT THEY ALLOWED THEIR PROMOTIONAL FUNCTIONS TO COMPLETELY DOMINATE THEIR REGULATORY FUNCTIONS. THE RESULT WAS THE SECURITIES ACT AMENDMENTS OF 1975.

I AM CONCERNED ABOUT THE EXTENT TO WHICH THE AUTHORITY OF THE SELF-REGULATORY ORGANIZATIONS HAS BEEN UNDERMINED BY THESE EVENTS, BECAUSE I SEE NO ALTERNATIVE TO SELF-REGULATION EXCEPT GOVERNMENT REGULATION. AND I DO NOT BELIEVE THAT INCREASED GOVERNMENT REGULATION IS THE ANSWER TO THE CAPITAL RAISING PROBLEMS WHICH THE PRIVATE SECTOR IS HAVING TODAY. I ALSO QUESTION WHETHER THE GOVERNMENT CAN BE AS EFFECTIVE A PROMOTER OF THE INDUSTRY'S REAL NEEDS AS THE INDUSTRY ITSELF. BUT THE AUTHORITY OF THE SELF-REGULATORY ORGANIZATIONS WILL NOT BE RESPECTED UNLESS THEY ARE SENSITIVE TO POLITICAL AND ECONOMIC CHANGE AND ARE ACCOUNTABLE TO THE INDUSTRY, THE GOVERNMENT AND THE INVESTING PUBLIC. IF THE SELF-REGULATORY ORGANIZATIONS BEHAVE LIKE MEDIEVAL GUILDS TRYING TO HOLD BACK COMPETITION OR CHANGE, THEY WILL NOT BE ABLE TO COMMAND THE RESPECT NECESSARY FOR THEIR SURVIVAL.

THE SECURITIES INDUSTRY ASSOCIATION IS NOT A SELF-REGULATORY ORGANIZATION BUT IT HAS A SIGNIFICANT LEADERSHIP POSITION IN THE SECURITIES INDUSTRY. I KNOW THAT I LOOK TO YOU FOR RESPONSIBLE COMMENT ON AND CONSTRUCTIVE CRITICISM OF SEC ACTIONS, AND I BELIEVE YOU ARE CAPABLE OF REPRESENTING THE INDUSTRY'S INTEREST WITHOUT COMPROMISING THE PUBLIC INTEREST. AS THE SEC GRAPPLES WITH THE PROBLEMS OF IMPLEMENTING OUR JANUARY STATEMENT ON THE NATIONAL MARKET SYSTEM, AND FACILITATING THE ESTABLISHMENT OF A NATIONAL CLEARANCE AND SETTLEMENT SYSTEM, WE WILL LOOK TO THE SIA FOR ASSISTANCE AND SUPPORT AS WELL AS CRITICISM.

I BELIEVE YOU MUST UNDERSTAND THAT THE PROMOTIONAL PROGRAMS ON WHICH THE SEC IS EMBARKED ARE A NEW EXPERIENCE, AND ADJUSTMENT TO CHANGE IS ALWAYS DIFFICULT. I AM CONFIDENT THAT THE SEC WILL FORMULATE A PROPER BALANCE BETWEEN ITS PROSECUTORIAL, REGULATORY AND PROMOTIONAL FUNCTIONS BECAUSE IT IS AN AGENCY WHICH HAS ALWAYS MANAGED TO BE AS FORWARD LOOKING AND RESILIENT AS THE INDUSTRY IT REGULATES.